



KENTUCKY RETIREMENT SYSTEMS

William A. Thielen, Executive Director

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January 26, 2015

Senator Joe Bowen
Capitol Annex, Room 228
702 Capitol Avenue
Frankfort, KY 40601

Dear Senator Bowen:

The purpose of this letter is to convey to you the Kentucky Retirement Systems' (KRS) initial comments on the impact or potential impact of the Senate Bill 2 (SB 2) proposals on KRS operations. The various proposals are addressed below by reference to SB 2 section numbers.

Section 2 (1)(e) and Section 2 (9)(a). Senate confirmation of six (6) appointed KRS trustees and the KRS executive director.

Kentucky's Governor appoints six (6) KRS trustees who serve four (4) year terms that begin either on April 1 or July 1 following the expiration of a term. The terms of the appointed trustees expire in different years. Current terms will expire in 2016 (2 trustees), 2017 (3 trustees) and 2019 (1 trustee). Each of the KRS trustees serve on 2-3 board committees in addition to serving on the full board. If Senate confirmation of appointed trustees is required, there is a potential for significant disruption of KRS board and committee operations and continuity on the board would be adversely affected. For example, it is very possible that three (3) trustees could be appointed to begin serving on July 1 of a year and one (1) or more of them could be required to vacate the position nine (9) months later at the conclusion of a legislative session, if the appointments are not confirmed. One (1) or more Board positions would then remain vacant for a period and the appointment process and confirmation process would have to be repeated. Also, when Senate Bill 2 was passed during the 2013 legislative session, three (3) of the Governor's appointees were required to be made from nominees submitted by the Kentucky Association of Counties, the Kentucky League of Cities and the Kentucky School Boards Association. This further complicates and has the potential to delay the appointment and confirmation process.

The comments above regarding the potential for disruption of KRS operations and the adverse impact on board continuity are also applicable to the proposal to subject the appointment of the KRS executive director to Senate confirmation. The executive director is currently appointed by the KRS Board of Trustees. When it has been necessary to fill the position of executive director, it has been the practice of the KRS board to conduct a nationwide search utilizing the services of a reputable and experienced executive search firm that is hired following a Request for Proposal (RFP) process. The requirement of Senate confirmation would have the potential to

unnecessarily politicize the process and may cause significant disruption if an appointee is not confirmed and the hiring process, which could take many months, must begin anew.

Section 2 (1)(e)5e and f. Revision of “investment experience” definition.

The proposed change in the definition of “investment experience” will tend to limit the Governor’s ability to appoint qualified persons to the KRS Board. Although additional investment experience on the board is certainly desirable, it may be difficult to find working investment professionals who have the available time to devote to KRS Investment Committee and board meetings, unless they are retired. If a working investment professional is appointed to the board, there is also a significant potential for conflicts of interest given the wide-ranging and comprehensive nature of the KRS investment program. An alternative might be the creation of an investment advisory group that would advise the KRS Board of Trustees, the Public Pension Oversight Board and others, much like the Consensus Forecasting Group advises the state budget office and LRC regarding revenue forecasts.

Section 2 (2)(d) and (f). Subject KRS Contracting and purchasing to Kentucky Model Procurement Code and KRS Chapters 56 and 57.

These changes will subject KRS to the Kentucky Model Procurement Code (MPC) under Kentucky Revised Statutes Chapter 45A for all purchases of goods and services. The KRS Board and staff currently operate under a Procurement Policy adopted by the KRS Board which mirrors in most respects the MPC. Under its procurement code, KRS uses processes very similar, if not identical, to those in the MPC. For instance, KRS uses a public Request for Proposal (RFP) process to purchase all goods and investment consulting, actuarial, auditing, medical, insurance and other technical and professional services, when the cost of such goods or services is expected to be \$40,000 or more in a fiscal year. Therefore, this amendment would seemingly be unnecessary.

The proposed amendment is apparently intended to require KRS to use an RFP process to hire investment managers. KRS currently has contracts with over 80 investment managers. These contracts are entered into after an extensive consulting and due diligence process by KRS investment staff and investment consultants. KRS has a due diligence policy included in its Investment Policy Statement that is developed by the KRS Investment Committee and ratified by the full KRS Board. All investment managers hired by KRS are approved at a public meeting by the KRS Investment Committee after staff and consultant have either jointly or separately made a recommendation to the Investment Committee regarding that specific manager. It should be noted that prior to recommending an investment manager to the KRS Investment Committee an onsite meeting with the manager at their primary office is conducted. This allows staff access to a broader number of employees to ask questions of and to visually see the resources of each manager.

If KRS is required to utilize an RFP process to hire an investment manager, it will cause extensive delays and increased administrative costs since KRS, rather than focusing on a few quality managers that have been identified after careful research by KRS staff and KRS investment consultants, will have to evaluate and respond to numerous RFP responses from investment managers that would otherwise not be considered.

Finally, subjecting KRS to the requirements of Kentucky Revised Statutes Chapters 56 and 57 would introduce several inconsistencies between how KRS Chapter 18A finance agencies are run and how KRS' enabling statutes are set up. These inconsistencies would have to be resolved or amended by subsequent legislation. These changes would likely result in a significant interruption of business until KRS and Finance can determine how to implement the new requirements and procedures. For example, Chapter 57 contains provisions regarding document printing. Provisions of this section may require the Governor, or designee, to pre-approve KRS publications and mailings and establish additional rules regarding printing materials. Also, Chapter 56 contains provisions regarding state property. It is unclear at this time what effect, if any, these provisions would have on KRS.

Section 2 (19)(i). Disclosure of investment fees and commissions.

KRS has been and will continue to work on a program to fully disclose all investment holdings, fees and commissions by asset class and by individual investment manager. However, in the case of certain asset classes, underlying fund of fund fees and holdings may not be obtainable. Further discussion of the way this provision is worded is necessary to avoid establishing a requirement that is not possible to meet.

Section 2 (19)(l). Subject all KRS contracts and offering documents to review by the legislature's Contract Review Subcommittee and the Auditor of Public Accounts.

This provision has the potential to create significant disruption and delays in KRS' operations, particularly its investment function. Furthermore, the Contract Review Committee process under KRS 45A.705 usurps the authority of the 13-member KRS Board of Trustees by placing ultimate authority with the Secretary of the Finance and Administration Cabinet to determine whether a contract shall be revised to comply with Contract Review Subcommittee objections, or canceled, or remain effective.

Section 2 (21). Prohibition on the payment of KRS funds to any placement agent.

KRS has no problem with this requirement. KRS has a comprehensive placement agent disclosure policy and has not approved payment of any funds to a placement agent since 2009.

Section 3 (1)(d). Application of ethics codes and codes of professional conduct to KRS employees, trustees, investment advisors and investment managers.

KRS has no problem with this requirement.

In conclusion, it is KRS' position that several of the provisions of SB 2, as outlined above, have the potential to create operational disruption, delays, inefficiencies and increased administrative costs. These proposals have not been sufficiently examined to determine their necessity and the full range of impacts that they may have on the operations of KRS. It is our position that these proposals should be referred to the Kentucky General Assembly's Public Pension Oversight Board so that they may be further discussed and analyzed regarding their impact on KRS.

If you have any questions regarding the contents of this letter or wish to discuss the issues in more detail, please do not hesitate to contact me.

Sincerely,



William A. Thielen
Executive Director

WAT/



COMMONWEALTH OF KENTUCKY
STATE SENATE
SENATOR JOE BOWEN
8TH DISTRICT

March 2, 2016

House State Government Committee Members
702 Capitol Avenue
Frankfort, KY 40601

RE: Senate Bill 2 (SB 2), Pension Transparency Accountability Legislation

Dear Colleagues:

I read with interest the Kentucky Retirement Systems (KRS) Executive Director's February 16, 2016, public letter to Chairman Yonts in opposition to Senate Bill 2 and am compelled to respond. Some of the objections in the letter were made by the KRS Executive Director when he testified in opposition to SB 2 when the legislation was considered by the Senate State and Local Government Committee. The bill, nonetheless, passed both the committee and in the full chamber with unanimous support.

This letter will address some of the objections raised in the correspondence.

1. *"Senate confirmation of appointed trustees...[creates] a potential for significant disruption of KRS board and committee operations..."*

Senate confirmation of board members is a crucial part of the selection process of several important executive branch agencies. It functions as a check on executive power to ensure that qualified individuals, and not those that simply have a relationship with the governor's office, are filling these positions. And the Senate has not, in my memory, indiscriminately denied a sitting governor confirmation of his appointments.

The KRS Executive Director worries that the prospect of trustees being forced to vacate their positions due to their not securing confirmation would be "disruptive." Sometimes disruption, however, is necessary for good government.

In the 2014 General Assembly, the Senate refused to confirm the reappointment of a commissioner of the Department of Fish and Wildlife after the commission failed in its oversight



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duties that are set forth in statute. Around the time period of the General Assembly session, the director of Fish and Wildlife was charged with nineteen counts of ethics violations by the Kentucky Executive Branch Ethics Commission and resigned under a settlement agreement in which he paid civil fines. When this particular commissioner, who shared the responsibility of overseeing the agency with the other commissioners, was reappointed by Governor Beshear, the Senate appropriately refused to confirm him because of the past failures to oversee the activities of the director. This may have been “disruptive” for the Department of Fish and Wildlife, but the Senate believed it was necessary to recover the integrity of the agency.

Senate confirmation is a vital check on executive power and, in my humble opinion, wielding this review power over a multi-billion dollar retirement system board is far more essential than exercising it over the Department of Fish and Wildlife.

2. *“Senate confirmation of the KRS executive director..[would] have the potential to unnecessarily politicize the process and cause significant disruption...”*

The KRS Executive Director, perhaps unsurprisingly, also goes on record in his letter as being opposed to the individual serving in his own position being subject to Senate confirmation. The possibility of “disruption” is again raised. This provision in Senate Bill 2, however, was actually prompted by the circumstances of his recent contract renewal and large salary increase, which received significant publicity in the press. Had this provision of SB 2 been in place prior to the contract renewal, the KRS Board would have perhaps been more deliberative in its processes.

Senate confirmation is required of several important executive positions in state government, and KRS 11.160 sets forth the procedure for Senate approval of appointments. Examples of government leadership positions subject to Senate confirmation include: Members of the Public Service Commission (KRS 278.050); Parole Board members (KRS 439.320); Mine Safety Review Commission members (KRS 351.1041); the Manager and Board of Directors for the Kentucky Employers’ Mutual Insurance Authority (KRS 342.809 and 342.813); Commissioners of the Department of Fish and Wildlife Resources (KRS 150.022); the Commissioner and Administrative Law Judges of the Department of Workers’ Claims (KRS 342.228 and 342.230); and the Governor-appointed directors of the Kentucky Housing Corporation (KRS 198A.030).

Obviously, as with all of these statutes, the possibility that the Senate's failure to confirm an appointee may "disrupt" the agency in the same manner as alleged by KRS, but that is subordinate to the priority of adequate oversight.

3. *"The proposed change in the definition of 'investment experience' will tend to limit the Governor's ability to appoint qualified persons to the KRS Board."*

The KRS Executive Director's letter expresses concern that raising the standards for what constitutes an investment professional will make it too difficult to find a qualified person to serve in that capacity and asserts that it will be difficult to avoid conflicts of interest.

Currently, KRS 61.645 requires that the Governor appoint two members of the KRS Board that have "investment experience." The statute states that "investment experience" means an individual who does not have a conflict of interest, as provided by KRS 61.655, and who has at least ten (10) years of experience in one of the following areas of expertise:

- a. A portfolio manager acting in a fiduciary capacity;
- b. A professional securities analyst or investment consultant;
- c. A current or retired employee or principal of a trust institution, investment or finance organization, or endowment fund acting in an investment-related capacity;
- d. A chartered financial analyst in good standing as determined by the CFA Institute;
- e. A university professor, teaching economics or investment-related
- f. Any other professional with exceptional experience in the field of public or private finances.

SB 2 would simply remove an economics professor from subsection e. and all of the text of subsection f. Subsection f. is the catchall for credentials which has diminished the expectation of high qualifications that was originally envisioned in the statute. House Bill 263 (HB 263), which passed the House of Representatives unanimously on February 2, 2016, also contains this same simple reform. Obviously, the intent of the reform is to raise the bar for the gubernatorial nominations of Board of Trustees members. With KRS's investment returns recently lagging certain benchmarks, its opposition to this reform is surprising. Ultimately, it is disappointing that under the current grim financial circumstances, KRS is resisting both Senate confirmation of board members and requiring that the Governor appoint truly qualified investment professionals to the board.

4. *“Application of the Kentucky Model Procurement Code...would not improve KRS’ contracting practices...[and] cause extensive delays and increased administrative costs...”*

SB 2 also would make KTRS and KRS subject to the Kentucky Model Procurement Code – and KRS opposes this in its letter to Chairman Yonts. KRS seeks to maintain its almost exclusive exemption in state government from model procurement laws by asserting it has its own internal regulations to address these concerns. There is no sound public policy basis for this statutory exemption, and the exemption removes KRS from being subject to the following provisions:

- ✓ The Finance Cabinet’s authority to investigate the mismanagement of state funds and the authority to remove any unnecessary officer of government or an officer grossly mismanaging state affairs (KRS 45.131);
- ✓ Anti-discrimination provisions for contractors (KRS 45.570);
- ✓ Requirement that the General Assembly approve the purchase of real property in excess of \$400,000 that is purchased through issuance of financial instruments such as bonds (KRS 45.763);
- ✓ Statutes that establish the Finance Cabinet as the central procurement and contracting agency (KRS 45A.045); sets forth the rules for awarding state contracts (KRS 45A.075); grants vendors the right to file a protest with the Finance Cabinet over the awarding of a contract (KRS 45A.285); sets forth conflict of interest and anti-kickback rules (KRS 45A.340 and 455); establishes workers’ compensation assurances of contractors (KRS 45A.480); establishes small or minority business set asides (KRS 45A.675); and makes personal service contracts subject to Government Contract Review Committee (GCRC) (KRS 45A.690 through 45A.725);

Requiring KRS and KTRS to be subject to the Model Procurement Code will provide vendors important protections when contracts are solicited and awarded. Making the agencies subject to the GCRC process will allow the General Assembly to review the fees paid by KRS and KTRS to outside contractors at the initial stages of the contract.

KRS further claims that SB 2 “usurps the authority of the 13-member KRS Board of Trustees by placing ultimate authority with the Secretary of the Finance and Administration Cabinet to determine whether a contract shall be revised to comply with Contract Review Subcommittee objections or canceled or remain effective.” My response is an emphatic “YES,” it does “usurp” that KRS authority and the General Assembly has every right to do so. The General

March 2, 2016

Assembly, of course, possesses the constitutional power to enumerate the authority and jurisdiction of the KRS Board of Trustees. SB 2 is written specifically to place the same “good government” procurement oversight and restraints on KRS and KTRS that all the other state agencies must adhere to, and that includes Finance Cabinet and GCRC oversight.

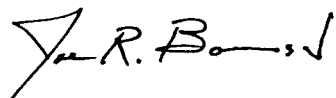
I will note that, because of its current exemptions, KRS has not been required to appear before the GCRC to justify paying attorney fees several times in excess of the \$125 per hour maximum state rate. It also paid paralegals at the rate of \$175 per hour – significantly more than most highly skilled attorneys that the state hires on contract.

Moreover, as you know, the General Assembly created the PPOB in 2013 to review the investments, benefits, bylaws, policies, and charters of KRS. It does not make sense, in light of this heightened oversight, that KRS still functions outside of the GCRC for its personal service contracting.

In conclusion, I will state that the tenor of the KRS Executive Director’s February 16, 2016, letter was very troubling. There is a national consensus that public pension systems need to operate in a more transparent environment, yet KRS persistently clings to a status quo that insulates it from the most basic types of executive and legislative oversight. And the oversight required by SB 2 simply places KRS and KTRS back under the same customary supervision required of the rest of state government agencies. Ultimately, taxpayers anticipate that when billions of dollars are being committed to these retirement systems, the General Assembly will ensure that a high level of fiscal accountability will be maintained. We have every right to require KRS to conform to these expectations.

I welcome the opportunity to discuss SB 2 with you further in the coming days of the session. Thank you for your attention to my concerns.

Sincerely,

A handwritten signature in black ink, appearing to read "Joe R. Bowen, J". The signature is fluid and cursive, with a large initial "J" and a checkmark-like flourish at the end.

Joe Bowen
State Senator



KENTUCKY RETIREMENT SYSTEMS

William A. Thielen, Executive Director

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February 16, 2016

Representative Brent Yonts
Capitol Annex, Room 366A
702 Capitol Avenue
Frankfort, KY 40601

Dear Representative Yonts:

The purpose of this letter is to convey to you the Kentucky Retirement Systems' (KRS) comments on the impact or potential impact of the Senate Bill 2 (SB 2)¹ proposals on KRS' operations.

Before addressing the specific provisions of SB 2, I want to confirm that KRS' Board of Trustees is dedicated to administering the pension system in a manner that is consistent with the Board's fiduciary duty, embodies the highest ethical standards, emphasizes transparency, is effective and efficient in order to maximize the benefit to its membership and the Commonwealth as a whole. Consistent with the Board's goal of ethical, efficient, and effective administration, when legislation is proposed that will negatively impact the administration, benefits, or stability of the pension funds, the Board is obligated to advise the Governor and the General Assembly of the negative impact of the plan sponsor's proposal. Unfortunately, while there are provisions in SB 2 that the Board does not think will negatively impact the Systems, several provisions will make the Systems less efficient, less competitive, and will result in the expenditure of additional funds at the very moment that KRS' constituency has asserted that the General Assembly should be taking all possible actions to maximize the Systems' financial stability.

KRS' concerns with SB 2 are as follows with the various proposals addressed by reference to SB 2 section numbers.

Section 2 (1)(e)

Senate confirmation of six (6) appointed KRS trustees.

Currently, Kentucky's Governor appoints six (6) KRS trustees who serve four (4) year terms that begin either on April 1 or July 1 following the expiration of a term. Pursuant to Senate Bill 2 passed during the 2013 regular session, three (3) of the Governor's appointees are required to be made from lists of nominees submitted by the Kentucky Association of Counties, the Kentucky League of Cities and the Kentucky School Boards Association. The terms of the appointed

¹ SB 2 w/ SCS1, SFA1, SFA2, SCA1

trustees expire in different years. Current terms will expire in 2016 (2 trustees), 2017 (3 trustees) and 2019 (1 trustee). Each of the KRS trustees serve on 2-3 board committees in addition to serving on the full board.

If Senate confirmation of appointed trustees is required, there is a potential for significant disruption of KRS board and committee operations and continuity on the board would be adversely affected with a resultant loss of important knowledge and experience. For example, it is very possible that three (3) trustees could be appointed to begin serving on July 1 of a year and one (1) or more of them could be required to vacate the position nine (9) months later at the conclusion of a legislative session, if the appointments are not confirmed. One (1) or more Board positions would then remain vacant for a period and the appointment process and confirmation process would have to be repeated.

Section 2 (9)(a)

Senate confirmation of the KRS executive director.

The comments above regarding the potential for disruption of KRS operations and the adverse impact on board continuity as the result of a board member confirmation process are also applicable to the proposal to subject the appointment of the KRS executive director to Senate confirmation. The executive director is currently appointed by the KRS Board of Trustees to act as the Board's chief administrative officer. When it has been necessary to fill the position of executive director, it has been the practice of the KRS board to conduct a nationwide search utilizing the services of a reputable and experienced executive search firm that is hired following a Request for Proposal (RFP) process. The requirement of Senate confirmation would have the potential to unnecessarily politicize the process and cause significant disruption, if an appointee is not confirmed and the hiring process, which could take many months, must begin anew.

Section 2 (1)(e)5e and f.

Revision of "investment experience" definition.

The proposed change in the definition of "investment experience" will tend to limit the Governor's ability to appoint qualified persons to the KRS Board. Although additional investment experience on the board is certainly desirable, it may be difficult to find working investment professionals who have the available time to devote to KRS Investment Committee and board meetings, unless they are retired. If a working investment professional is appointed to the board, there is also a significant potential for conflicts of interest given the wide-ranging and comprehensive nature of the KRS investment program. An alternative might be the creation of an investment advisory group that would advise the KRS Board of Trustees, the Public Pension Oversight Board and others, much like the Consensus Forecasting Group advises the state budget office and LRC regarding revenue forecasts.

Section 2 (2)(d) and (f).

Application of the Kentucky Model Procurement Code and KRS Chapters 56 and 57 to KRS.

These changes will subject KRS to the Kentucky Model Procurement Code (MPC) under Kentucky Revised Statutes Chapter 45A for all purchases of goods and services. The KRS Board and staff currently operate under a Procurement Policy adopted by the KRS Board which mirrors in most respects the MPC, but is designed to allow KRS to address the specific needs of the pension system. For instance, KRS uses a public Request for Proposal (RFP) process to purchase all goods and investment consulting, actuarial, auditing, medical, insurance and other technical and professional services, when the cost of such goods or services is expected to be \$40,000 or more in a fiscal year. Therefore, this amendment would not improve KRS' contracting practices because they already embody the intent of the code by ensuring an open and competitive contracting process resulting in KRS paying a fair price for the services provided.

The proposed amendment is apparently also intended to require KRS to use an RFP process to hire investment managers. While an RFP process may be ideal to purchase paper or computers, it is not good investment practice to choose managers proposing the lowest cost, rather investors must choose managers based upon their ability to perform. KRS currently has contracts with over 100 investment managers. These contracts are entered into after an extensive consulting and due diligence process by KRS investment staff and nationally recognized investment consultants that identify desirable investments that fit into needs of KRS' investment portfolio. KRS' due diligence process is set forth in its Investment Policy Statement that is developed by the KRS Investment Committee and ratified by the full KRS Board. All investment managers hired by KRS are approved at a public meeting by the KRS Investment Committee after staff and consultant have either jointly or separately made a recommendation to the Investment Committee regarding that specific manager.

If KRS is required to utilize an RFP process to hire an investment manager, it will cause extensive delays and increased administrative costs. Rather than focusing on a few quality managers that have been identified after careful research by KRS staff and KRS investment consultant, the staff and investment consultants will have to review and score numerous RFP responses that may be submitted by managers that are not qualified. More importantly, KRS might be forced into contracting with investment managers against the advice of its internal investment staff, as well as external investment advisors. Put simply, KRS Chapter 45A was not designed for the investment of billions of dollars of trust assets and will significantly diminish KRS' ability to meet its assumed rate of return.

Finally, subjecting KRS to the requirements of Kentucky Revised Statutes Chapters 56 and 57 would introduce several inconsistencies between how KRS Chapter 18A finance agencies are run

and how KRS' enabling statutes are set up. These inconsistencies would have to be resolved or amended by subsequent legislation. These changes would likely result in a significant interruption of business until KRS and Finance can determine how to implement the new requirements and procedures. For example, Chapter 57 contains provisions regarding document printing. Provisions of this section may require the Governor, or designee, to pre-approve KRS publications and mailings and establish additional rules regarding printing materials. Also, Chapter 56 contains provisions regarding state property. It is unclear at this time what effect, if any, these provisions would have on KRS.

Section 2 (9)(b) and (c)

Subjecting KRS to the Chapter 18A State Personnel System

Prior to December 1, 2002, KRS' personnel were employed pursuant to the provisions and processes set forth in Kentucky Revised States Chapter 18A as administered by the Kentucky Personnel Cabinet. The following is representative of the basic process under the 18A system:

A new or vacated non-classified/non-merit position:

- *The Governor's Office is notified of the opening*
- *KRS attaches any resume's/information*
- *The Governor's Office approves or disapproves filling the opening*
 - ❖ *The last KRS attorney hired in this manner accepted the position, but had to wait approximately 3 months for the Governor's Office to issue an Executive Order approving the hire.*

A new or vacated classified/merit position:

- *KRS prepared a description and sent a request for the register to Personnel*
- *KRS post the position internally and qualifies any internal employees*
- *KRS posts the position*
- *Personnel Cabinet administers tests, pre-qualifies external applicants*
- *The job classifications and salary range is set by the Personnel Cabinet*
 - ❖ *Resulted in a large number of employees being misclassified (i.e., an "Investment Accounting Specialist" actually performing HR payroll functions.)*
- *The Personnel Cabinet follows through on any Americans with Disabilities Act issues, and other compliance matters*
- *The Personnel Cabinet made final hiring/promotion determinations irrespective of KRS business needs, performance, or qualifications.*

As a result of rising pension system membership and changing membership demographics, KRS' Board of Trustees undertook a fiduciary review to ensure they were acting in the best interest of the Systems' membership and beneficiaries as well as prepare the Systems for foreseeable challenges in the future. One of the shortcomings identified by the fiduciary review and noted to be an obstacle in the path of the Board fulfilling its fiduciary duty was staffing through the Commonwealth's 18A merit system. Public pension plans such as KRS are separate and distinct from other state agencies because of the fiduciary duties to the membership, rather than the state as a whole. Consequently, nationally recognized uniform standards² have recommended that administration must be separated to avoid actual or perceived conflicts of interest.

The unique operations of KRS were restricted by the 18A classification and compensation system. For many KRS positions, there were no comparable classifications in state government and the other major statewide retirement system, Kentucky Teachers' Retirement System, was an independent agency. Consequently, KRS could not design a classifications and compensation structure consistent with the unique duties that KRS' employees performed.

The limitations created by the 18A classification and compensation system had an impact on member retirement administration and customer service. For example, KRS 61.690 mandates that a member who files a retirement application be provided an estimate of his monthly benefit within ten days of receipt of the application. In order to meet that statutory deadline for service and other business needs, counselors at the time were working a combined average of 680 hours of overtime per month. Once the retirement applications were processed, the retiree's benefits must be set up in the payroll system to issue the monthly retirement benefit. To ensure that new retirees will received their retirement benefits on time the Systems' Retiree Services Division were working more than 500 hours of overtime per month at the time. Moreover, as a result of the large number of retirements and other requests, such as service purchase costs, installments, transfer and rollovers, KRS was 3-4 months behind on filling these requests.

The issues and challenges described above had a significant impact on KRS' ability to attract and retain staff under the 18A classification and compensation system. At the time significant numbers of trained KRS staff left KRS to seek more desirable positions with less demanding workloads and/or greater pay at KTRS³ or elsewhere in the Commonwealth's Personnel Systems. These defections came after KRS invested a minimum of 6 to 8 months to adequately train a retirement counselor. KRS' turnover numbers from calendar years 1999 and 2000 are set forth below.

² UMPERSA, Uniform Management of Public Employee Retirement Systems Act.

³ KTRS Salaries were on average 45% higher.

- 1999 14.9% Overall turnover (191 Total Positions)
50.0% Employer Reporting and Education
12.5% Benefits Counselors
36.4% Call Center Counselors
50.0% Insurance Counselors
- 2000 24.9% Overall turnover (191 Total Positions)
66.6% Employer Reporting and Education
58.3% Benefits Counselors
23.1% Call Center Counselors
75.0% Insurance Counselors

Eventually, the identified resolution of KRS staffing concerns was to remove KRS from the Commonwealth's merit system and create a KRS specific system with similar merit protections, benefits, and leave, but designed to meet the needs of the pension system. Moreover, a KRS specific personnel system allowed for a classification and compensation systems that is based upon and rewards performance, as opposed to longevity, a known shortcoming of the Commonwealth's personnel system.

KRS' personnel system limitations were eventually addressed in HB 309 (2002 Regular Session), which amended KRS 61.645 to provide for KRS' Board of Trustees to establish and administer an independent personnel system. In the years following the passage of HB 309, KRS has slowly been able to stabilize its workforce, build expertise amongst its staff, modernize its administration of benefits, and provide a higher level of service to its constituents. KRS' independent personnel system has allowed it to react appropriately to membership roles that have basically doubled since 1993⁴ and significant legislative changes such as HB 1 in 2008 and SB 2 in 2013.

Finally, KRS has implemented its personnel system over the past 13 years with the acquisition of expensive and complex software systems designed to meet its unique needs. A return of KRS to the 18A personnel system will eliminate the use of these systems to some extent and require KRS to report through the State KHRIS system. Both the current KRS systems and the KHRIS system would have to be reprogrammed to create an interface. It is anticipated that it will take KRS and the Personnel Cabinet many months at significant cost to recode the systems to handle KRS personnel.

⁴ Growth in active membership (Approximately 116,000 in 1993 to approximately 136,000 as of 06/30/2015; Growth in inactive membership (Approximately 28,000 in 1993 to approximately 121,000 as of 06/30/2015; Growth in retired membership (Approximately 36,000 in 1993 to approximately 97,000 as of 06/30/2015.)

In conclusion, KRS' removal from the 18A classification and compensation system has overall been very positive. Proposals that are enacted without due thought or impact analysis risk undermining all the positive progress that has been made since 2002 and may paralyze KRS going forward. Without a competitive and flexible personnel system that can react to the ever changing retirement administration landscape KRS will be unlikely to fulfill its fiduciary duties to its members and beneficiaries in the future.

Section 2 (19)(i)

Disclosure of investment fees and commissions.

KRS has been and will continue implementing a program to fully disclose all investment holdings, fees and commissions by asset class and by individual investment manager. However, in the case of certain asset classes, underlying fund of fund fees and holdings may not be obtainable. Further discussion of the way this provision is worded is necessary to avoid establishing a requirement that is not possible to meet.

Section 2 (19)(l)

Subject KRS contracts and offering documents to review by the Contract Review Subcommittee and the Auditor of Public Accounts.

This provision has the potential to create significant disruption and delays in KRS' operations, particularly its investment function. Furthermore, the Contract Review Committee process under KRS 45A.705 usurps the authority of the 13-member KRS Board of Trustees by placing ultimate authority with the Secretary of the Finance and Administration Cabinet to determine whether a contract shall be revised to comply with Contract Review Subcommittee objections, or canceled, or remain effective. This in effect gives one KRS Board of Trustee member the ability to control KRS contracting.

Section 2 (21)

Prohibition on the payment of KRS funds to any placement agent.

KRS has no problem with this requirement. KRS has a comprehensive placement agent disclosure policy and has not approved payment of any funds to a placement agent since 2009.

Section 3 (1)(d)

Application of ethics codes and codes of professional conduct to KRS employees, trustees, investment advisors and investment managers.

KRS has no problem with this requirement. However, it should be noted that requiring external investment managers to adopt additional codes of ethics (in addition to the Investment Advisers Act code of conduct) in contracts or investment side letters may be resisted and may result in the loss of some investment opportunities if an investment manager will not agree.

In conclusion, it is KRS' position that several of the provisions of SB 2, as outlined above, have the potential to create very significant operational disruption, delays, inefficiencies and increased administrative costs. These proposals have not been sufficiently examined to determine their necessity and the full range of impacts that they may have on the operations of KRS. It is our position that these proposals should be referred to the Kentucky General Assembly's Public Pension Oversight Board so that they may be further discussed and fully analyzed regarding their impact on KRS.

If you have any questions regarding the contents of this letter or wish to discuss the issues in more detail, please do not hesitate to contact me.

Sincerely,



William A. Thielen
Executive Director

WAT/